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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Honorable E (Kika) de la Garza Chairman, Committee On Agriculture House Of Representatives

Federal Insurance Program For Grain Warehouse Depositors --Issues And Information

Grain warehouse insolvencies can result in financial losses to farmers and other customers--losses that can adversely affect the individuals and local communities involved. The House Agriculture Committee's Ad Hoc Subcommittee on Grain Elevator Bankruptcy recommended various actions designed to help prevent failures and aid in the recovery of losses and suggested that GAO further study the concept of federal deposit insurance protections.

This report considers patterning a grain deposit insurance program after the Federal Deposit Insurance Corporation Program and

--describes the FDIC Program;

--summarizes the principal issues that grain warehouse operators, regulators, and depositors believe should be addressed;

--estimates certain potential program costs; and

--describes existing federal, state, and private programs that already provide financial protection.

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

B-217659

The Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives

Dear Mr. Chairman:

Grain warehouse insolvencies over the past few years have raised concern about the farmer's risk in storing grain in public warehouses. If a warehouse fails, the farmer stands to lose part or all of the value of his/her grain. The adverse effects of such losses to the individuals and local communities involved can be quite serious.

According to a recent study published by the Illinois Legislative Council[1] (the most comprehensive data on grain warehouse failures of which we are aware), a total of 165 insolvencies were reported in eight grain-producing states from January 1974 through May 1982--an average annual rate of less than 0.2 percent of licensed facilities in those states. Losses to grain account claimants (those involved in either storage or sales transactions with the failed facilities) totaled almost $35 million (about 60 percent of claims) in 76 of the 165 insolvencies for which sufficient information on losses was available.

Congressional attention has been focused on ways to help prevent failures and to aid in the recovery of losses from failures. Noting that the grain storage and banking industries have striking similarities, the House Agriculture Ad Hoc Subcommittee on Grain Elevator Bankruptcy suggested in its June 16, 1983, report further study of federal deposit insurance protections for grain warehouses.

In line with the Ad Hoc Subcommittee's suggestion, your July 11, 1983, letter asked that we study the possible establishment of a federal deposit insurance program for grain warehouses comparable to programs available to banks through the Federal

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[1]Richard Casey, Dennis M. Conley, and John W. Ahlen, Grain Elevator Insolvencies and Bankruptcies in Eight North Central States 1974-1982, Illinois Legislative Council, Springfield, Illinois, Memorandum File 9-391, March 1984.

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Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC). Such a program would protect depositors against financial losses due to warehouse insolvencies.

As agreed subsequently with your office and the Ad Hoc Subcommittee, this report contains the following information deemed relevant to further consideration of this concept:

1. A description of the FDIC Program. (With some variation, the FSLIC Program operates essentially in the same way.)

2. The principal issues and problems attendant to applying such a program to the grain warehouse industry.

3. The potential cost of such a program.

4. State programs and private insurance policies that already provide financial protection to depositors.

5. A description of existing federal grain warehouse licensing and examination programs.

The information is summarized below; details are contained in appendixes I through VI. We presented much of this information to the Ad Hoc Subcommittee orally in an earlier briefing.

As agreed with your office, we relied on those who would be most affected (grain warehouse regulators, operators, and depositors) to identify for us the primary issues and concerns that should be addressed in deciding whether to establish an FDIC-type program for grain warehouses. We solicited the views of all major national organizations representing these interests of which we are aware, as well as the views of similar local organizations in 12 states which comprise one-half of the nation's off-farm grain storage capacity--a total of 111 parties.

As agreed with your office, we did not attempt to conclude whether an insurance program should be established. In commenting on our draft report, the U.S. Department of Agriculture's (USDA's) Agricultural Stabilization and Conservation Service (ASCS) stated that in its opinion potential program costs would outweigh potential benefits. ASCS' comments are reproduced in full in appendix VIII.

We developed our estimates of some possible grain deposit insurance program costs with USDA's assistance. However, we had no basis for estimating the costs of certain possible program features. (App. II details our cost-estimating methods and describes important cost-affecting assumptions that we made.) We

obtained information on state financial protection programs and private insurance policies directly from administering agencies and officials. (App. VII discusses our objectives, scope, and methodology in greater detail.)

DESCRIPTION OF THE FDIC PROGRAM

The Congress created FDIC (an independent federal agency) in 1933 in the wake of a 4-year period of record bank failures and depositor losses--an estimated $1.3 billion lost in almost 9,100 failures. FDIC's creation was part of a legislative package aimed at restoring public confidence in the banking system and stabilizing the nation's monetary system. The legislation placed a number of restrictions on banks' activities to help assure a safer banking system.

A year after creating FDIC, the Congress established FSLIC--a similar insurance program for savings and loan associations. The National Credit Union Share Insurance Fund (NCUSIF) followed 36 years later (in 1970), bringing credit unions under the federal deposit insurance umbrella. With some variation, all three funds operate essentially in the same way. As agreed with your office, we obtained details only on the FDIC Program.

FDIC insurance protects all individual and business checking, time, and savings accounts at insured banks up to $100,000 per depositor. A depositor is insured up to $100,000 in the aggregate with respect to all deposits held in the same right and capacity in each insured bank. (The terms "right" and "capacity" refer to the nature of ownership of deposits, such as individual, joint, or trust deposits.) A depositor may obtain more coverage by opening like accounts at different insured banks, but not at different branches of the same bank.

When FDIC insurance took effect January 1, 1934, coverage was limited by law to $2,500 per depositor, but 6 months later the Congress raised that limit to $5,000. Five subsequent increases led to the current $100,000-per-depositor limit, in effect since March 31, 1980.

FDIC insurance is mandatory for all federally chartered commercial banks (called national banks) and for all state-chartered banks that are members of the Federal Reserve System. While not a federal requirement for other state-chartered banks, FDIC insurance is a chartering prerequisite in nearly all states. FDIC insured about 98 percent of the roughly 15,000 eligible institutions in the nation at the close of 1982 (the latest year for which such data are available).

FDIC was funded initially with $150 million appropriated by the Congress and a total of $139 million provided by the Federal Reserve banks. The agency completed repayment of its initial capitalization, plus $81 million interest, in 1948. It since has been financed entirely by assessments (premiums) paid by insured banks and by interest earned through investments in federal securities. At the end of 1983, FDIC's insurance fund stood at $15.3 billion--about 1.2 percent of estimated insured deposits. Although FDIC also has contingent authority to borrow up to $3 billion from the U.S. Treasury in an emergency, it has never needed to do so.

FDIC assesses insured banks at the rate of one-twelfth of 1 percent of average total deposits. The effective rate which banks actually pay however, is less, varying annually between one-thirtieth and one-thirteenth of 1 percent since 1961. The effective rate is the result of a stipulation added to the law in 1950. It requires FDIC to return (in the form of a credit against future assessments) a portion (currently 60 percent) of assessments remaining after FDIC deducts its insurance losses and expenses. In 1980 the Congress authorized FDIC's Board of Directors to make adjustments to the assessment credit (within certain limits) so as to generally maintain the insurance fund at no less than 1.1 percent and no more than 1.4 percent of estimated <u>insured</u> deposits.

When an insured bank fails, FDIC generally can provide funds to arrange what is called a deposit assumption, in which another bank (either a new or existing bank) takes over many of the assets of the failed bank and assumes its total deposits and other stated liabilities. In such instances, FDIC may take over and liquidate any assets that the acquiring bank does not want.

FDIC is authorized to take certain other direct actions to reduce or avert a threatened loss to the fund. Such actions include arranging a merger of a failing insured bank with another insured bank and providing capital, loans, or deposit assistance to troubled banks.

If an assumption transaction or direct assistance cannot be arranged, FDIC pays each depositor in full, up to the $100,000 insurance limit. In these so-called direct payoff cases, deposits in excess of the limit are usually treated as general debts of the bank and their owners receive a pro rata share of the proceeds from liquidating the bank's assets. FDIC also is responsible in most cases for liquidating the assets of insured banks that are involved in direct payoff cases. Through this process of turning the failed bank's assets into cash, FDIC (which is entitled to collect the claims of depositors to the extent of its insurance

payments) seeks to recover costs incurred by the insurance fund, to settle the closed bank's debts, and to return any excess to shareholders.

In addition to the foregoing direct insurance responsibilities, FDIC regulates and supervises all insured state-chartered banks that are not members of the Federal Reserve System[2] (roughly 8,900) and about 300 insured mutual savings banks. In fact, bank supervision accounts for the majority of FDIC's administrative operating expenses--about 63 percent of the agency's $135.7 million total administrative operating expenses (excluding receivership expenses, which are charged directly to failed bank accounts) for calendar year 1983.

Bank examination, FDIC's principal supervisory activity, is designed to protect depositors and the insurance fund by assessing the safety and soundness of individual banks. Through these examinations, conducted at least once every 3 years, FDIC determines the financial condition of each bank and obtains a better understanding of its risk in insuring the bank's deposits. These examinations are quite comprehensive and include evaluation of capital adequacy; the quality of assets (most importantly, loans), earnings, and management; and the availability of adequate funding sources. Authority to require financial reports, to initiate formal enforcement actions (when necessary to correct unsound banking practices), and to enforce a number of civil rights and consumer protection laws (such as the Truth in Lending Act) round out FDIC's bank supervisory powers.

PRINCIPAL ISSUES RELEVANT TO AN FDIC-TYPE PROGRAM FOR GRAIN WAREHOUSES

There is limited support for an FDIC-type insurance program among those who would be affected most directly should such a program be established for the grain warehouse industry--state and federal regulators, warehouse operators, and farmers/producers.

We asked a total of 111 parties, representing the various interests associated with the grain warehousing industry, whether they favored establishing a federal deposit insurance program for

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[2]The Federal Reserve System regulates and supervises those state-chartered banks that are members of the system (about 1,000). All federally chartered banks (about 4,500) are members of the Federal Reserve System, but they are regulated and supervised by the Department of the Treasury's Office of the Comptroller of the Currency.

grain warehouses patterned after FDIC. (See app. VII for a description of our methodology for selecting the parties.) We also asked them to identify what they considered to be the major issues or concerns that should be addressed in deciding whether to establish such a program. In all, we solicited input from 15 parties representing the views of federal and state grain warehouse regulatory agencies, 26 groups representing grain warehouse operators, 65 groups representing farmers and producers, and 5 groups representing other interested parties, such as banks specializing in grain warehouse financing. The 84 respondents (a response rate of 76 percent) consisted of all 15 regulatory agencies, 23 operator groups, 41 farmer/producer groups, and 5 other interested parties.

The strongest support for an FDIC-type program came from farmer/producer groups, with 37 percent (15 of 41 respondents) favoring the idea. Even so, a slightly greater proportion of such groups opposed the idea (17 of 41 respondents, or 41 percent). The greatest opposition came from operator groups. Eighteen of 23 responding operator groups (78 percent) opposed, while only 1 was in favor. (The remaining four operator groups expressed no opinion.) Opposition from regulatory agencies was almost as great, with 67 percent (10 of 15) opposed, 13 percent (2 of 15) in favor, and 20 percent (3 of 15) indicating no opinion.

The potentially high cost of an FDIC-type program was the most frequently raised concern. Overall, 48 percent of the respondents cited this as a concern. Well over half of the regulatory and operator respondents were concerned about potential costs, while 29 percent (12 of 41) of the farmer/producer groups cited costs as a concern.

In all, we identified 11 prevalent[3] issues and/or concerns from the affected parties' responses. (See list that follows.) Appendix I shows the number and percentage of regulatory, operator, producer, and other parties that raised each of these concerns.

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[3]Those raised by at least 10 percent of the respondents. It should be noted, however, that the percentages do not necessarily represent all the parties that might be concerned about the issue. Instead they represent only those who raised the concern in their responses to us. If we had submitted a list of these concerns to each respondent, it is possible that more might have considered them a concern.

Prevalent Issues/Concerns Raised by Affected Parties

	Issue/concern	Percentage of respondents
1.	The potentially high cost of the program.	48
2.	The possible expansion of current regulatory and examination activities that the program may require. (App. VI summarizes current federal warehouse licensing and examination requirements, procedures, and costs.)	31
3.	Uncertainty or concern about whom the insurance would or should cover.	25
4.	The possibility that the program may encourage unsound warehouse management or depositor business decisions.	23
5.	The potential impact that the program could have on existing state and private insurance programs or bonding requirements.	21
6.	Whether participation in the program would be mandatory or voluntary.	20
7.	Whether the program might be better handled at the state or local level.	12
8.	What, if any, dollar limitation there should be on the coverage.	11
9.	Whether the warehouse failure problem is great enough to justify the program.	11
10.	The method that should be used to finance the program or assess premiums.	10
11.	Potential duplication of state programs or laws that already provide depositor protection.	10

POSSIBLE COST OF AN FDIC-TYPE PROGRAM FOR GRAIN WAREHOUSES

As agreed with your office, we estimated some of the possible costs of a grain warehouse deposit insurance program patterned after the FDIC Program. We estimated the costs of two basic features of such a program--an insurance fund and a new agency which performs financial soundness examinations of insured warehouses. In developing the cost estimate for the insurance fund, we assumed that the fund would need approximately the same percentage of insured deposits as the FDIC Program and that it would be accumulated over a 5-year period. USDA program officials estimated the costs to administer such a program on the basis of the costs of their current warehouse examination program. The estimated costs of these features ranged from about $41 million to $72 million annually. These costs would equal about $4,000-$5,000 a year for each grain warehouse in the nation. Allocated to grain that might be insured, our estimated costs would equate to about 0.5 cent to 0.7 cent per bushel marketed commercially each year. Neither we nor USDA had a basis for estimating potential grain insurance program losses or the potential grain program costs for certain FDIC functions, such as liquidating failed facilities, providing various forms of financial assistance to insured facilities, and arranging mergers of financially troubled facilities. Accordingly, no such costs are included in our estimates.

We had to make various assumptions about the program's design in order to arrive at our cost estimates. As agreed with your office, we assumed that the grain-insuring agency, like FDIC, would determine the financial soundness of insured institutions through periodic examinations. We made various other cost-affecting assumptions about the program's design, such as the number of facilities and types of depositors that might be insured (see app. II). Accordingly, the relevancy of our cost estimates hinges to a large degree on the extent to which our assumptions and limitations correspond to the specific design features of any such program receiving further consideration.

STATE FINANCIAL COMPENSATION PROVISIONS AND PRIVATE INSURANCE POLICIES

The only provisions we found for financial compensation to depositors in the event of grain warehouse insolvencies were (1) state requirements for grain warehouse or dealer surety bonds, (2) some existing state indemnity funds, and (3) policies offered by two private insurance companies. As of April 1984, at least 29 states required some degree of bonding for grain warehouses and/or dealers, and 6 states had some sort of active indemnity fund or insurance program.

State bonding requirements

A warehouse bond is a surety contract between a warehouse operator and an approved surety company to protect third parties having an interest in the products stored in the warehouse. The amount of the bond required has a direct bearing on any monetary settlement a depositor may receive in the event of the warehouse's insolvency. Bonding requirements offer depositors protection not only because of the monetary compensation that bonds provide, but also because the bonding company reviews the warehouse's financial circumstances before issuing a bond.

As we reported in 1981,[4] state bonding requirements differ significantly, even in fundamental areas such as the basis for determining the bond amount and prescribed minimums and maximums. (Selected features of the state bonding requirements are presented in app. III.) For example, the 29 states that require bonds employ a total of 12 different basic methods to determine bond amounts. Most of these methods in some way relate the amount of bond required to capacity or to the volume/value of grain handled. Nine of the 29 states use a different basis to determine bond amounts for warehouses than that used for dealers.[5] A majority of the 29 states prescribe both maximum and minimum bond amounts, while most of the rest prescribe minimums only. Prescribed minimums range from $2,000 (for dealer bonds in Colorado) to $50,000 (in North Dakota and Washington). Excluding South Carolina (where the state appoints individual warehouse managers and supplies a blanket bond covering commodities stored under state warehouse receipts), prescribed maximum bond amounts range from $50,000 in Florida and Minnesota to $1 million in Mississippi, Missouri, and Montana.

We asked each of the 29 states for readily available information on the degree to which bonds have covered claims in past insolvencies. We did not seek such information from other sources. Only Iowa and Montana provided actual data. In Iowa

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[4]More Can Be Done to Protect Depositors at Federally Examined Grain Warehouses (CED-81-112, June 19, 1981).

[5]The term "warehouse" often is used to describe a facility that stores grain owned by others and that buys and sells grain as well. According to USDA, almost all facilities that store grain commercially also engage in buying and selling (merchandising). Some states, however, distinguish between these activities (or facilities) for licensing purposes by using the term "warehouse" to refer to storage activities and the term "dealer" to refer to merchandising activities.

bonds have covered about 21 percent of claims and in Montana about 6 percent. Six other states provided us widely divergent estimates of bond coverage: 10 percent of claims in North Carolina, 25 percent in Georgia, 25-40 percent in Colorado, 65-75 percent in Arkansas, and 70-100 percent in Kentucky. Five other states made general statements regarding the adequacy of bond coverage: Indiana said that bonds generally cover all claims; Kansas and Washington said they did not; while New York and North Dakota said that bonds usually cover all claims on stored grain but not all claims on grain involved in merchandising transactions. In all, 17 of the 29 states provided some indication of bonding adequacy. Most of the remaining 12 states said that they did not have a sufficient history of insolvencies on which to base a response.

It should be noted that depositors' overall recovery rates can often be greater than provided by the bond. This is because depositors usually share in the liquidated assets of the failed facility. For example, data supplied to us by Iowa indicate that while bonds have covered only 21 percent of claims, the overall recovery rate in past cases has been about 95 percent. Four other states (unable to specifically estimate bond coverage) estimated their overall recovery rates at 35-40 percent (Idaho), 75 percent (Michigan), 60-100 percent (Texas), and 100 percent (Oregon).

To our knowledge, the most comprehensive data on past grain warehouse insolvency losses are contained in the previously mentioned March 1984 study published by the Illinois Legislative Council. (See p. 1.) The study is based on 90 of 165 insolvencies reported in Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Ohio, and Wisconsin from January 1974 through May 1982. The authors found from available information in 76 of the 90 insolvencies that grain depositors overall recovered 40 percent of their claims (about $23.6 million of $58.3 million). In 36 cases warehouse bonds covered 27 percent of depositors' claims (about $3.3 million of $12.4 million); whereas the overall recovery rate in these 36 cases was 47 percent.

State indemnity funds

An indemnity fund is money set aside as security against loss, hurt, or damage. As of September 1984, the states of Illinois, Kentucky, New York, Ohio, Oklahoma, and South Carolina had active indemnity funds or similar programs which provided depositors varying degrees of protection against losses incurred in grain warehouse failures.

These programs differed greatly in basic features, such as the commodities and types of transactions covered, costs to participants, and amount of protection provided. (App. IV compares

the basic features of the programs.) In general, however, the programs reimburse those sustaining covered financial losses using money set aside for this purpose that is collected from the covered facilities or their customers. Illinois and Ohio do not require bonding in addition to participation in the fund. The other four states, however, also require bonding, and either they cover only losses remaining after recovery from the bond or they collect on the bond and reimburse their indemnity funds accordingly.

The Montana legislature in April 1983 authorized its Department of Agriculture to buy an insurance contract from a private company to protect grain producers. However, as of April 1984, the program had not been implemented because no companies had bid on the contract. Maryland once had an indemnity fund but repealed it effective July 1, 1983, on the recommendation of a special task force. Among reasons the task force cited for its decision were (1) higher than estimated costs, (2) concern that the fund encouraged dealers to take risks and offered depositors a false sense of security, (3) recordkeeping burdens imposed on dealers, and (4) the strengthening of the state's licensing law.

Private insurance programs

Little private insurance for grain warehouse depositors is available, and sales of such policies have been slow--about 3,600 sales of the two existing policies of which we are aware. These policies--offered primarily in Iowa and Minnesota by the Farm Bureau Mutual Company and the Employers Mutual Casualty Company, both located in Des Moines, Iowa--differ in both costs and coverage. For example, the Farm Bureau policy can be purchased in increments of $50,000 (up to a total of $200,000 in coverage) at a cost of $35 for the first increment and $15 for each additional increment. The Employers Mutual policy costs 1 percent of the coverage amount. The Farm Bureau policy covers 80 percent of losses incurred on grain stored under warehouse receipts while the Employers Mutual policy covers 100 percent of such losses. (App. V describes these and other basic terms of the two policies.) Country Mutual Insurance Company of Bloomington, Illinois, once offered a policy to Illinois Farm Bureau members but ceased doing so when the state of Illinois established its own insurance program in August 1983.

AGENCY COMMENTS AND OUR EVALUATION

FDIC suggested several minor changes to improve the technical accuracy of our description of the FDIC Program. We incorporated the suggested changes into this final report.

ASCS stated that our report did not carry the information presented to its logical conclusion--i.e., that insurance program costs would outweigh the benefits. ASCS said that our estimated program costs ($41 million to $72 million, annually) are substantially greater than estimated losses due to grain warehouse failures over the past 8 years, as shown in the Illinois Legislative Council study. (The full text of ASCS' comments appears in app. VIII.)

As discussed previously, the requested purpose of our report was to provide the Committee with information it deemed necessary to further conduct deliberations on the need for such a federal insurance program. In our opinion, it would be premature and inappropriate for us to categorically rule out such a program at this time solely on the basis of limited available cost/benefit data.

ASCS said it is uncertain what the cost effect of such a program would be on the Commodity Credit Corporation (CCC), but it suspects it would be detrimental. ASCS noted that such a program likely would increase CCC's storage costs without providing additional benefits. (CCC contracts with public warehouses to store and handle both federally owned commodities and producer-owned commodities which have been pledged as collateral for certain federal loans. It also pays part of the costs of examining these warehouses.) (See app. VI.)

We agree with the uncertainty of the potential cost effects on CCC. The ultimate cost and benefits to CCC will, in our view, depend on whether CCC grain is insured under the program and on CCC's success in negotiating fair storage rates for benefits received. Assuming that CCC-owned and loan collateral grain were excluded from the program and that insurance costs were passed on to depositors in the form of higher storage fees, CCC should insist on appropriate fee reductions. In any event, it seems reasonable to assume that CCC, like any other depositor, would benefit from the intensified financial soundness examination procedures which would almost certainly be a feature of any federal grain deposit insurance program.

ASCS also questioned our basis for calculating per-bushel program costs. Rather than basing these calculations on an average number of bushels estimated to be in commercial storage at any given time during the year, ASCS suggested that we use 10 billion bushels--its estimate of the total bushels of grain that annually enter the commercial marketing chain. We agree that this would yield a more realistic estimate of potential program cost to depositors. Most states which now operate indemnity funds assess a fee on each insured bushel delivered to the warehouse. (See

app. IV.) Accordingly, we recomputed our unit cost estimates as ASCS suggested. (See app. II.) We also made certain factual corrections suggested by ASCS to our description of federal warehouse licensing and examination programs (see app. VI).

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time we will send copies of the report to the Director, Office of Management and Budget; the Secretary of Agriculture; the Chairman, Federal Deposit Insurance Corporation; and other interested parties. We also will make copies available to others upon request.

Sincerely yours,

Ralph Kadow for

J. Dexter Peach
Director

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ABBREVIATIONS

AMS	Agricultural Marketing Service
ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
FDIC	Federal Deposit Insurance Corporation
GAO	General Accounting Office
PIK	payment-in-kind
UGSA	uniform grain storage agreement
USDA	U.S. Department of Agriculture

APPENDIX I

MAJOR ISSUES/CONCERNS THAT AFFECTED PARTIES BELIEVE SHOULD BE ADDRESSED IN DECIDING WHETHER TO ESTABLISH AN FDIC-TYPE INSURANCE PROGRAM FOR GRAIN WAREHOUSES[a]

Issue/concern	Number and (percentage) of respondents raising the issue/concern: All groups	Regulatory groups	Operator groups	Producer groups	Others[b]
1. The potentially high cost of the program.	40 (48%)	10 (67%)	15 (65%)	12 (29%)	3 (60%)
2. The possible expansion of current regulatory and examination activities that the program may require.	26 (31%)	2 (13%)	15 (65%)	6 (15%)	3 (60%)
3. Uncertainty or concern as to who the insurance would or should cover.	21 (25%)	8 (53%)	8 (35%)	4 (10%)	1 (20%)
4. The possibility that the program may encourage unsound warehouse management or depositor business decisions.	19 (23%)	2 (13%)	12 (52%)	4 (10%)	1 (20%)
5. The potential impact the program could have on existing state and private insurance programs or bonding requirements.	18 (21%)	7 (47%)	4 (17%)	6 (15%)	1 (20%)
6. Whether participation in the program would be mandatory or voluntary.	17 (20%)	5 (33%)	5 (22%)	4 (10%)	3 (60%)
7. Whether the program might be better handled at the state or local level.	10 (12%)	2 (13%)	3 (13%)	4 (10%)	1 (20%)
8. What, if any, dollar limitation there should be on the coverage.	9 (11%)	2 (13%)	3 (13%)	4 (10%)	0
9. Whether the warehouse failure problem is great enough to justify the program.	9 (11%)	1 (7%)	4 (17%)	3 (7%)	1 (20%)
0. The method that should be used to finance the program or assess premiums.	8 (10%)	1 (7%)	2 (9%)	4 (10%)	1 (20%)
1. Potential duplication of state programs or laws that already provide despositor protection.	8 (10%)	0	3 (13%)	5 (12%)	0

[a]The respondents listed for us the issues/concerns they believed should be addressed. We grouped similar specific responses into the 11 more general categories shown. We did not poll potential respondents for their views on a predetermined list of potential issues/concerns. Appendix VII describes in detail our methods for obtaining this information and for identifying those parties that we asked to provide their views.

[b]Consists of the following 5 respondents: 2 banks; a private insurance company offering grain warehouse depositor coverage; a trade association representing grain exchanges and marketing associations; and an Oklahoma State senator who volunteered his views.

GAO's METHODS FOR ESTIMATING SOME POSSIBLE COSTS OF AN FDIC-TYPE INSURANCE PROGRAM FOR GRAIN WAREHOUSES

We requested the Agricultural Marketing Service's (AMS') Warehouse and Seed Division[1] to estimate the annual cost of a new agency to administer the insurance program and to perform financial soundness examinations of insured facilities. It estimated this cost at $25.7 million annually, assuming coverage of 10,000 facilities; at $30.7 million annually, assuming 12,000 insured facilities; and at $35.7 million annually, assuming 14,000 insured facilities.[2] These amounts include the costs of setting up the new agency and assume that the agency will already have available from each facility unqualified audit reports prepared by certified public accountants, as well as quarterly position (inventory) reports. Neither of these now is a federal requirement.[3] Absence of these reports would require more frequent examinations and higher costs than estimated.

We reviewed but did not verify the accuracy of AMS' cost estimates. In estimating the cost of a new administering agency, AMS considered the number of field offices and personnel it would need to cover 10,000, 12,000, and 14,000 facilities, respectively. It prepared a detailed analysis of the salary, fringe benefit, travel, furniture, equipment, rent, and administrative/overhead costs for these offices and personnel and for a headquarters office and personnel. In determining the number of warehouse examiners that would be needed, AMS assumed continuation of its current average examination frequency (1.3 examinations per facility

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[1]At the time of our audit work, AMS' Warehouse and Seed Division administered the federal warehouse licensing and examination program. The division and program subsequently were transferred to the U.S. Department of Agriculture's (USDA's) Agricultural Stabilization and Conservation Service (ASCS).

[2]Estimates of the total number of grain storage facilities nationwide range from 10,000 to 14,000. The exact number is not known.

[3]Federally licensed warehouses and those approved under government contracts (uniform grain storage agreements) to store grain owned by the Commodity Credit Corporation (CCC) or grain owned by producers and held as loan collateral by CCC must submit financial statements to USDA. These must be audited or reviewed by a certified public accountant (CPA) or independent public accountant, unless from a specially exempted facility that is under a storage agreement only. USDA program officials estimate that 15-20 percent of financial statements from federally licensed warehouses, and 10 percent of those from warehouses under storage agreements only, are audited by a CPA. The officials estimate that from 300 to 350 warehouses are specially exempted.

per year) and estimated the additional time needed to expand current examination procedures in order to better assess each facility's financial soundness. It estimated that the expanded effort would increase average examination time from 32 to 48 hours (a 50-percent increase) per facility. The additional time would be used primarily to review a facility's merchandising (buying and selling) transactions, to more thoroughly verify its unreceipted (open) storage obligations, and to assess its overall financial soundness.

Also, we estimated the additional cost to build up a reserve insurance fund. We assumed that, like FDIC, the fund would be maintained at a level between 1.1 percent and 1.4 percent of average insured deposits. We estimated possible maximum and minimum insured deposit amounts on the basis of estimated average values of grain stored commercially during 1983--a maximum $13 billion (assuming insurance on all commercially stored grain) and a minimum $6.9 billion (assuming that neither CCC-owned nor loan collateral grain would be insured).[4] Applying the 1.1 and 1.4 percent criteria to these amounts yielded a fund maximum of $182 million and a minimum of about $76 million. Dividing these amounts equally over 5 years (an arbitrarily selected period over which to build up the fund) resulted in annual contributions to the fund ranging from about $15.2 million to $36.4 million. (These amounts assume no insurance losses and no interest income during the period.) As shown in the following table, these figures yielded a $40.9 million to $72.1 million range of total annual program costs.

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[4]In our report entitled Reduction in Federal Expenditures Possible Through Commodity Credit Corporation's Assumption of Insured Warehousing Risks (GAO/RED-75-320, Jan. 10, 1975) we took the position that CCC should be a self-insurer and recommended that CCC stop purchasing private insurance against loss of stored grain due to hazards (such as fire) and warehouse shortages--a recommendation which CCC implemented. While neither that report nor our current review sought to assess the propriety of CCC participation in a federal deposit insurance program, we assumed that CCC participation could be open to question and that exclusion of CCC-owned and loan collateral grain from the program would represent a plausible basis for estimating a minimum amount of grain that might be insured.

GAO's Calculation of Some Possible Grain Deposit Insurance Program Costs

	Minimum	Maximum
Average bushels of insured grain stored commercially	2.0 billion	4.1 billion
Average value of insured grain stored commercially	$6.9 billion	$13.0 billion
Amount needed for reserve insurance fund	$75.9 million	$182.0 million
Annual program costs (1st 5 years)		
Insurance fund contribution	$15.2 million	$36.4 million
Administrative costs	25.7 million	35.7 million
Total	$40.9 million	$72.1 million

We also calculated the average cost per warehouse and average cost per bushel that might be expected, as shown in the following table.

GAO's Calculations of Possible Annual Unit Costs for Grain Deposit Insurance Program

	Minimum	Maximum
Per warehouse:		
Annual program costs	$40.9 million	$72.1 million
Number of insured warehouses	10,000	14,000
Average cost per warehouse	$4,090	$5,150
Per bushel marketed commercially:		
Annual program costs	$40.9 million	$72.1 million
Number of annual bushels marketed commercially[a]	8.6 billion	10.6 billion
Average cost per bushel	0.5 cent	0.7 cent

[a]Estimates provided by USDA's Agricultural Stabilization and Conservation Service.

STATE BONDING REQUIREMENTS

States Requiring Grain Warehouse Bonding

State	Required for all facilities	Required for selected facilities only	Require special bond if facility engages in buying/selling	Accept certificate of deposit or other form of security in lieu of bond
Alabama	X		X	
Arkansas	X			X
Colorado	X		X	
Florida	X[a]			
Georgia	X		X	
Idaho	X			
Indiana	X		X[b]	
Iowa	X		X	
Kansas	X			
Kentucky	X		X	X
Louisiana	X		X	X
Maryland		X[c]		
Michigan	X[f]			
Minnesota	X[f]		X	
Mississippi	X			X
Missouri	X			
Montana	X		X	
Nebraska	X		X	X
New York	X			
North Carolina	X			
North Dakota	X[f]			
Oklahoma	X			
Oregon	X			
South Carolina[d]	X		X	
South Dakota	X			
Texas	X			
Washington	X			
Wisconsin		X[e]		
Wyoming	X	—	—	—
Total	27	2	11	5

[a]Florida requires bond only for grain dealers but has few public warehouses that store grain.

[b]Indiana requires separate bond if facility engages in deferred-price contracting (purchasing grain now with price to be agreed upon later).

[c]Maryland requires $100,000 bond only if a warehouse does not provide the state with an annual financial statement that has been audited by a certified public accountant.

[d]South Carolina technically runs the warehouse system. It appoints a manager for each facility and supplies a blanket bond for all managers which covers grain stored under warehouse receipts. Those dealing must post a separate bond.

[e]Wisconsin requires a bond only of facilities that do not meet certain specified financial criteria.

[f]Bond does not cover credit transactions (such as deferred-price contracts) in which the producer transfers title to grain to the purchasing facility, but agrees to defer receipt of payment.

States With Authority to Require an Extra Bond in Specified Circumstances

State	Extra bond is required[a]	Extra bond is discretionary
Alabama		X
Arkansas[b]	X	X
Colorado		X
Georgia	X	
Idaho		X
Indiana[b]	X	X
Iowa	X	
Kansas		X
Kentucky		X
Louisiana		X
Minnesota		X
Mississippi	X	
Missouri[b]	X	X
Montana		X
Oregon		X
South Carolina		X[c]
Texas	X	
Washington	X	
Wyoming	X	—
Total	9	13

[a]In most cases the extra bond is required to make up for a deficit in prescribed net assets (the difference between total assets and liabilities, also referred to as net worth)--i.e., the states prescribe a minimum amount of net worth or net assets but require facilities having less than these amounts to post an extra bond in an amount at least equal to the difference in their actual net worth/assets and the prescribed minimum.

[b]The additional bond is required in some circumstances and is discretionary in others.

[c]Applies to dealer bond only.

Minimum and Maximum Bond Amounts

State	Minimum amount	Maximum amount
Alabama (Warehouse)	$ 5,000	None
(Dealer)	25,000	$ 100,000
Arkansas	20,000	None
Colorado (Warehouse)	10,000	500,000
(Dealer)	2,000	200,000
Florida (Dealer)	3,000	50,000
Georgia (Warehouse & Dealer)	20,000	150,000
Idaho	25,000	500,000
Indiana (Warehouse)[a]	5,000	100,000
Iowa (Warehouse)	6,000	None
(Dealer)	(b)	(b)
Kansas	10,000	None
Kentucky (Warehouse)	10,000	None
(Dealer)	25,000	100,000
Louisiana (Warehouse & Dealer)	25,000	500,000
Maryland	(b)	(b)
Michigan	15,000	400,000
Minnesota (Warehouse)	20,000	500,000
(Dealer)	10,000	50,000
Mississippi	20,000	1,000,000
Missouri	10,000	1,000,000
Montana (Warehouse & Dealer)	20,000	1,000,000
Nebraska (Warehouse)	5,000	None
(Dealer)	25,000	100,000
New York	3,000	200,000
North Carolina	(b)	(b)
North Dakota	50,000	None
Oklahoma	25,000	500,000

(continued)

State	Minimum amount	Maximum amount
Oregon	$ 5,000	$ 200,000
South Carolina (Warehouse)	None	3,000,000
(Dealer)	None	25,000
South Dakota	5,000	None
Texas	15,000	500,000
Washington	50,000	750,000
Wisconsin	None	None
Wyoming	15,000	None

[a]Indiana also requires a separate bond if a facility engages in deferred-price contracting (purchasing grain now with price to be agreed upon later). As of November 28, 1984, the state had not finalized implementing regulations for the bond, and the director of the state's warehouse licensing agency could not estimate when the regulations would be finalized. Accordingly, it was uncertain at the time what, if any, minimum or maximum amounts the state would prescribe.

[b]The bond is a set amount and thus has no maximum or minimum.

Bases for Determining Bond Amount

1. The following 15 bonds are based on a specific amount per bushel or other increment of storage capacity:

Alabama (Warehouse)	Kentucky (Warehouse)	Nebraska (Warehouse)
Arkansas	Louisiana	North Dakota
Colorado (Warehouse)	Mississippi	Oklahoma
Indiana (Warehouse)	Missouri	Oregon
Iowa (Warehouse)	Montana (Warehouse)	Texas

2. Dealer bonds in the following eight states are based on percentages of the dollar value of business done or purchases made over a given period of time:

Alabama	Kentucky
Colorado	Montana
Florida	Nebraska
Georgia	South Carolina

3. The following three bonds are based on percentages of the dollar value of commodities when facility is filled to its maximum storage capacity:

Georgia (Warehouse)
Kansas
Wyoming

4. The following four bonds are based on a percentage (or the entire) dollar value of grain in storage or covered by warehouse receipts:

Minnesota (Warehouse)
South Carolina (Warehouse)
South Dakota
Wisconsin (Bond is required only of warehouses that do not meet specified financial criteria)

5. Idaho requires a bond equal to a specified amount per bushel of storage capacity or a percentage of the value of commodities stored, whichever is greater.

6. Iowa requires dealers to have a bond in one of two fixed amounts (either $25,000 or $50,000) depending on the dollar value of their grain purchases during the year and/or their use of deferred-price contracts.

7. Washington requires a bond equal to a specified amount per bushel of licensed capacity or specified percentage of gross sales, whichever is greater.

8. Michigan's bonds are fixed amounts based on specified increments of grain covered by warehouse receipts.

9. Minnesota's dealer bonds are fixed amounts based on increments of the dollar value of the facility's annual purchases.

10. Nebraska requires dealers who operate trucks to have a bond in one of five fixed amounts (ranging from $12,000 to $52,000) depending on the number of trucks they operate.

11. New York has a formula to determine the required amount which takes into account dollar value of purchases, compliance history, financial condition, and the state's general experience with the company.

12. North Carolina requires a flat amount ($10,000) for all facilities, whereas Maryland requires a flat amount ($100,000) only for facilities that do not provide the state with an annual financial statement that has been audited by a certified public accountant.

KEY FEATURES OF STATE GRAIN WAREHOUSE INDEMNITY/INSURANCE PROGRAMS

State	Commodities covered	Who is covered
Illinois	Corn, wheat, oats, rye, soybeans, barley and grain sorghums, kafir corn, buckwheat, flaxseed, edible beans, and others approved by the Illinois Department of Agriculture.	Depositors, sellers, and lenders with evidence of ownership.
Kentucky	Corn, wheat, oats, rye, soybeans, barley, grain sorghums, popcorn, and others approved by the Kentucky Department of Agriculture.	Anyone with written evidence of ownership of stored grain. Anyone lending money to facility within 21 days before failure who has not been repaid. Any producer with written evidence of grain sold to the facility who was not paid in full.
New York[a]	All farm products except processed grains, dairy products, and timber products.	Producers having transactions involving covered farm products with commission merchants, dealers, brokers, and processing plants. Cooperatives that deal exclusively with members and those who are required to file a bond under the Packers and Stockyard Act are excluded.
Ohio	Barley, corn, oats, rye, grain sorghum, soybeans, wheat, sunflower seeds, speltz, and others desigated by Ohio Director of Agriculture.	Producers delivering a commodity to a licensed handler for storage, conditioning, shipment, or sale. Creditors holding scale tickets or warehouse receipts. Licensed handlers storing their own grain or grain owned by another dealer.

(continued)

State	Commodities covered	Who Is Covered
Oklahoma	Corn, wheat, rye, oats, barley, sorghum, and soybeans.	Producers retaining ownership of grain held by a grain warehouse.
South Carolina[b]		
Warehouse fund	Cotton, soybeans, feedgrains and oilseeds.	Any holder of state warehouse receipt.
Dealers fund	Any feedgrain or oilseed, except cottonseed.	Producers having a written contract who have delivered grain to a dealer/handler but who have not received payment.

[a]The New York fund is a recent addition to a longstanding law requiring licensing and bonding of commodity merchants, dealers, brokers, and processors. The purposes of the program are to suppress and prevent unfair and fraudulent practices in the marketing of farm products and to safeguard producers and processors in certain marketing transactions. New York has only a few (less than 10) public grain warehouses, but they come under the act.

[b]In South Carolina the state technically operates the warehouse system. The state leases the warehouses from individual operators and appoints a manager at each warehouse who is technically a state employee but who is paid by the warehouse. He is the only one authorized to issue state warehouse receipts. The state supplies a blanket insurance policy covering hazards for all warehouses. It also supplies a blanket bond covering all managers for 50 percent of outstanding warehouse receipt liability, up to $3 million each. The state also has two separate indemnity-type funds. One fund (in operation for many years) guarantees state warehouse receipts, while the second (initiated in May 1982) protects producers from losses due to grain dealer bankruptcies.

(continued)

State	Mandatory or optional participation?	Method for financing
Illinois	Mandatory for state-licensed facilities. Optional for federally licensed facilities.	Fee paid by operators equivalent to amount they formerly paid for surety bond. (Indemnity fund replaced state's bonding requirement at same cost to operators.)
Kentucky	Mandatory, with the exception that nonresident producers can elect not to participate.	Per bushel assessment on all grain marketed. Operators deduct assessment from payment due seller and forward to the state insurance agency. (Out-of-state sellers may obtain exemption.)
New York	Optional; however, those electing not to participate must post a bond equaling at least 90% of the dollar value of their purchases during the previous year.	Incremental fees, based on dollar value of annual purchases, paid annually by licensee. Licensee can recover portion of fee (not to exceed 50%) from producers by charging them varying prescribed amounts (1.5 cents to 25 cents) per $100 of sales. These amounts depend on the fee which the licensee paid to the state.
Ohio	Mandatory for state-licensed facilities. Grain stored under warehouse receipt in federally licensed facility is exempt.	Per bushel fee paid by operator for all grain delivered by producers and all grain stored under warehouse receipt, regardless of owner.
Oklahoma	Mandatory.	Per bushel assessment on operator for all grain delivered by producers.

(continued)

State	Mandatory or optional participation?	Method for financing
South Carolina Warehouse fund	Mandatory.	At present fund sustained primarily by interest income. Special assessment on operator for each issued warehouse receipt is authorized, if needed.
Dealers fund	Optional (for producers).	Per bushel assessment for all grain delivered to facility, except that sold for cash or that stored under warehouse receipt. Operator collects assessment from producers and remits to state.

APPENDIX IV

(continued)

State	Amount of assessment/fee	Limitations on fund/assessments
Illinois	Warehouses pay $7.50 for each $1,000 of bond formerly required by state, up to $10,000 of bond. Rate drops to $5 per $1,000 for next $15,000 of bond and $3 per $1,000 for bond amount over $25,000. Dealers pay $10 for each $1,000 of bond formerly required.	Fee waived when fund exceeds $3 million.
Kentucky	1/2 cent per bushel.	Assessment waived when fund exceeds $3 million.
New York	$2,500 if annual purchases $5 million or more $1,750 if " " $3-$5 million $1,000 if " " $1-$3 million $ 750 if " " $500,000 - $1 million $ 500 if " " $300,000-$500,000 $ 300 if " " $50,000-$300,000 $ 200 if " " $20,000-$50,000 $ 100 if " " $3,000-$20,000 Those initially joining the fund in its second and third years of operation will pay two and three times these amounts, respectively.	Fund is not liable for claims which accrue before it reaches $1 million. Whenever the fund reaches $4 million, the state must suspend collection of the fee and/or suspend or reduce bonding requirements.
Ohio	1/2 cent per bushel.	Fee waived when fund equals 1/2 amount of claims approved during preceding 4 years or $4 million, whichever is greater.
Oklahoma	2/10 cent per bushel.	Assessment is waived when fund exceeds $10 million.
South Carolina Warehouse fund	1 cent per bushel of soybeans, 1/2 cent per bushel of other grains, and 10 cents per bale of cotton.	Fund is limited to $3 million. Special Assessment must cease when fund exceeds $750,000.

(continued)

State	Amount of assessment/fee	Limitations on fund/assessments
South Carolina Dealers fund	1 cent per bushel of soybeans and 1/2 cent per bushel of other grains.	Assessment is waived when fund exceeds $6 million. Fund cannot drop below $500,000.

(continued)

State	Procedures in event fund is insufficient to pay claims	Coverage provided
Illinois	State legislature will appropriate amounts necessary to pay claims.	100% of valid claims for grain stored under warehouse receipts. For other grain delivered to dealer, 85% of claim, with a maximum payment of $100,000 per claim.
Kentucky	State legislature will appropriate up to $1.5 million, to be repaid by the fund with interest when funds become available.	85% of valid claims for losses due to warehouse failures. 80% of valid claims for dealer failures, up to maximum payment of $100,000 per claim. Warehouse receipts surrendered for payment are covered 100% in all cases.
New York	Amount available from fund is divided pro rata among claimants.	Balance of claim remaining after recovery from the bond and from any credit insurance policy in force. (State is authorized to purchase credit insurance with fee revenues.) Payment from fund limited to 80% of difference between amount recovered under bond and the amount owed the claimant.
Ohio	Claims are held and paid as sufficient assets become available.	100% of the first $10,000 of loss, and 80% of the remaining loss.
Oklahoma	Claims for year are paid on pro rata basis, with unpaid portions paid in subsequent years as funds become available.	100% of losses.

(continued)

State	Procedures in event fund is insufficient to pay claims	Coverage provided
South Carolina		
Warehouse fund	Not specified; however, special assessment on operators is authorized when fund falls below $750,000. (See pp. 16 and 17.)	Losses in excess of amounts recoverable under the bond and hazard insurance for all commodities stored under state warehouse receipts.
Dealers fund	Claims for year are paid on pro rata basis, with unpaid portions paid in subsequent years as funds become available.	25% of loss if fund has $0.5-$1.5 million. 50% of loss if fund has $1.5-$3.0 million. 75% of loss if fund has $3.0-$4.5 million. 100% of loss if fund has $4.5-$6.0 million.

(continued)

State	Date established	Claims history
Illinois	August 1983	$573,000 in claims paid as of September 1, 1984. (Does not take into account amounts the fund recovered, such as from liquidation of failed facilities' assets.)
Kentucky	July 1984	None as of September 1, 1984.
New York	June 1984	None as of September 1, 1984.
Ohio	July 1983	$1,571,822 in claims paid as of September 1, 1984.
Oklahoma	July 1980	No claims paid as of September 1, 1984. However, potential claims totaling about $360,000 were pending. These arose from facility that failed about the time the fund became effective and the state must decide whether or not the claims are covered.
South Carolina		
Warehouse fund	Exact date not readily available. Has been in existence many years.	No major claims in recent years.
Dealers fund	May 1982	None paid as of September 1, 1984.

(continued)

State	State's views on its program
Illinois	Program has worked well thus far.
Kentucky	Is too early to adequately assess the program.
New York	Is too early to adequately assess the program.
Ohio	Program has worked as planned thus far. Expect it will prove successful in the future.
Oklahoma	Is difficult to assess how well fund works because no claims have been paid. Believe the fund, in conjunction with bonds, provides producers adequate protection.
South Carolina	
Warehouse fund	Program has worked well.
Dealers fund	Is too early to adequately assess the program's merits, but believe it will prove beneficial. Has experienced some problems with dealers improperly collecting assessments.

PRIVATE INSURANCE COVERAGE AVAILABLE TO GRAIN WAREHOUSE DEPOSITORS

We obtained information from two private companies known to offer depositors insurance protection against grain elevator bankruptcies. The Farm Bureau Mutual Company offers such a policy, but it is available only to members of the Iowa and Minnesota Farm Bureaus. The Employers Mutual Casualty Company also offers such a policy. It can be purchased by any Iowa grain producer.

The two companies' policies differ in both coverage and cost. The Farm Bureau policy covers grain produced in Iowa or Minnesota and grain in the Payment-in-Kind (PIK) Program which is stored at licensed warehouses or sold to licensed grain dealers on priced-later or deferred-payment contracts. The warehouse or dealer, however, must be in Iowa or Minnesota or within 75 miles of the state's border. Coverage can be purchased in increments of $50,000, up to a total of $200,000. The policy covers 80 percent of losses on grain stored under warehouse receipts. Unreceipted (open storage) grain, and grain sold under either price-later or deferred-payment contracts, are covered for 80 percent of losses occurring within 90 days after delivery. For losses occurring more than 90 days after delivery, coverage decreases by 1 percent for each week beyond 90 days, with minimum coverage being 60 percent of the loss. The enrollment period is June 1 through July 31 of each year for coverage effective from September 1 of that year to August 31 of the following year. As of January 1984, the premium was $35 for the first $50,000 of coverage plus $15 for each additional increment of $50,000.

The Employers Mutual policy covers only grain stored in bonded warehouses or grain sold to bonded dealers. The coverage does not extend to grain delivered to warehouses or dealers that are located more than 75 miles from the policyholder's address. The policy covers 100 percent of net losses (up to the policy amount) arising from a bonded warehouse's failure and 75 percent of net losses arising from a bonded grain dealer's failure. The policy does not cover grain that is delivered to the warehouse or dealer more than 90 days prior to the policy inception date. As of January 1984, the Employers Mutual policy premium was 1 percent of the coverage amount. An official of the Employers Mutual Company told us that the company is considering lowering the premium.

Sales of the policies have been slow. According to a Farm Bureau Mutual Insurance Company official, sales are significantly less than market projections. A market survey projected sales at 20,000 policies, but the Bureau has sold about 3,500. About 3,000 of these policies were sold in Iowa and about 500 were sold in Minnesota. About 80 percent of the policies were for the minimum available coverage ($50,000).

The Bureau did a follow-up survey to find out why sales fell short of projections. The survey revealed that grain producers did not buy insurance because they had confidence in the warehouse with which they were doing business. Consequently, they did not think they needed the insurance.

The Bureau has received four claims. The claims had not been finalized as of early 1984, but the Bureau estimated losses at about $30,000.

Employers Mutual has sold about 100 policies in the three harvest seasons it has offered the insurance. About half of these policies were sold in Iowa and half in Illinois. (Employers Mutual at one time sold its policy in Illinois, but stopped doing so because the state of Illinois stopped requiring bonding when its indemnity fund went into effect.) Most policies have been sold to absentee landlords, farm management companies, or bank trust departments. The company has not paid any losses.

DESCRIPTION AND COSTS OF EXISTING FEDERAL GRAIN WAREHOUSE LICENSING AND EXAMINATION PROGRAMS

Although there is no federal insurance covering grain warehouse deposits, the U.S. Department of Agriculture's warehouse licensing and examination programs are designed to help ensure that depositors have safe facilities in which to store their commodities. USDA administers a voluntary licensing and examination program under the U.S. Warehouse Act, as amended (7 U.S.C. 241 et seq.). It also sets requirements for and examines warehouses storing commodities owned by the Commodity Credit Corporation or pledged to CCC as loan collateral.

The warehouse act is permissive in that it applies only to facilities that voluntarily apply for a license and that are found to qualify. By maintaining a federal license, operators demonstrate to their depositors that they meet federal requirements for proper and sound warehouse operations.

Licensed warehouses must issue receipts as evidence that the depositor's products are in storage. All such receipts, printed under government contract, must be ordered from USDA. A warehouse receipt may be issued only when the products are actually received in the licensed warehouse, and the receipts must be surrendered to the warehouse and canceled before the products may be removed from storage. Receipts issued are supported by inspection and/or weight certificates issued by warehouse inspectors and weighers licensed under the act.

To qualify for a federal license, an operator must have suitable and properly equipped facilities, a good business reputation, and a minimum allowable net worth computed on the basis of warehouse capacity and the type of commodity stored. Net worth of at least $25,000 is required in all cases. Each year the operator must furnish an acceptable bond in an amount also based on capacity. The bond must be at least $20,000 but need not be greater than $500,000 (unless USDA requires an additional bond to cover a deficiency in required net worth). Federally licensed warehouses also must provide USDA annually (or more often) with financial statements, prepared in accordance with generally accepted accounting principles, which have been audited or reviewed by a certified or independent public accountant.

Once licensed, warehouses are subject to periodic, unannounced examinations by USDA to ensure compliance with the act. Examiners review the warehouse's obligations to depositors as represented by outstanding warehouse receipts and other records. The examiners inventory all commodities on hand, comparing this inventory with the warehouse's record of obligations. They also

review the warehouse's recordkeeping, housekeeping, sanitation, and hazard insurance coverage and check the quality of the products in storage.

USDA also sets requirements for and examines warehouses storing commodities for the Commodity Credit Corporation--a federally established corporation comprised of top-level USDA officials. In carrying out its various price-support programs, CCC contracts with public warehouses to store and handle commodities which it owns or which producers own and have pledged to it as collateral for government loans. For grain, CCC enters into these contracts through uniform grain storage agreements (UGSAs).

Approval and examination requirements for UGSA warehouses are similar to those for federally licensed warehouses, the primary differences being in bonding and financial reporting requirements. Unlike federally licensed warehouses, UGSA warehouses need not provide a bond (except to cover a deficit in required net worth). Also, if specifically authorized by CCC's Deputy Vice President, a UGSA facility may submit with its financial statement a compilation report prepared by a grain commission firm or management firm.[1] Compilation reports, which present unaudited and unreviewed information provided to the preparer by warehouse management, include no opinion or other form of assurance from the preparer. Compilation reports are not allowed for federally licensed warehouses.

According to USDA, there were about 1,700 federally licensed grain warehouses and 6,300 UGSA warehouses as of May 1, 1984. (According to the Chief of USDA's Warehouse Development Branch, almost all of the federally licensed facilities also held UGSAs.) As of that time, only about 2,600 of the UGSA facilities were storing grain for CCC. However, all warehouses are examined at least once a year. In addition, about 700 warehouses had been approved as payment-in-kind (PIK) handlers that had been dropped from the list of approved UGSA warehouses following the end of the 1983 PIK Program.

During fiscal year 1983, USDA expended 125 staff years and obligated almost $4.7 million in its grain warehouse examination programs. Federally licensed facilities (including those also having UGSAs) accounted for 78 staff years and about $2.8 million, while UGSA facilities without federal licenses accounted for the remaining 47 staff years and $1.9 million. CCC paid about

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[1]Firms that (under contract) market grain for small warehouses and that also provide financial accounting and management services to the warehouses. Such firms number less than six and operate in the Dakotas, Montana, and parts of Minnesota. USDA program officials estimate that 300 to 350 warehouses submit compilation reports.

$3.3 million of these costs (the entire cost for nonfederally licensed facilities having USGAs and about one-half the cost for federally licensed facilities also having UGSAs). Operators of federally licensed warehouses paid the remaining costs through user fees.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to provide the Committee with the following agreed-upon information that it deemed relevant to the issue of establishing a federal, FDIC-type deposit insurance program for grain warehouses:

1. A description of the FDIC Program.
2. The principal issues and problems attendant to applying such a program to the grain warehouse industry.
3. The potential cost of such a program.
4. State law provisions that provide financial compensation to depositors when warehouses fail and the degree to which the laws have covered past losses.
5. A description of existing state and private warehouse depositor insurance programs, how well they have worked, and their costs to depositors.
6. A description of existing federal grain warehouse licensing and examination programs.

As agreed with your office, we relied on those who would be primarily affected by such a system (grain warehouse regulators, operators, and depositors) to identify the principal accompanying issues and problems, and we did not attempt to reach a conclusion as to whether or not such a program should be established. We asked for views from federal and state warehouse regulatory agencies, from national and local organizations representing the interests of grain warehouse operators and grain producers (farmers), and from other interested parties. We sought views from all major national organizations of which we were aware that represent the interests of grain warehouse operators and of grain farmers. We also sought the views of grain warehouse regulators and of local organizations representing the interests of grain warehouse operators and grain farmers in 12 states. We relied primarily on the national organizations and on state regulatory officials to identify appropriate state-level organizations. We selected the states of Illinois, Iowa, Kansas, Maryland, Montana, Nebraska, Ohio, Oklahoma, and South Carolina because they either operated insurance/indemnity programs or had considered such programs. We also included Missouri, Minnesota, and Wisconsin because they were major grain states and had active warehouse regulatory programs. As of January 1, 1984, these 12 states accounted for about 50 percent of the off-farm grain storage facilities and about 61 percent of the off-farm grain storage capacity in the nation. Those from whom we sought views included (1) ASCS' Warehouse Division and Transportation and Storage Division in Washington, D.C., and USDA's Warehouse Service Center and ASCS'

field office in Kansas City, Missouri, (2) the Association of American Warehouse Control Officials (a professional organization of state warehouse regulatory officials whose members represent all states known to regulate warehousing), and (3) a private insurance company.

In all we asked 111 parties for their views. As requested, we previously provided your office with a list of these parties, which your office found to be satisfactory. In all but a few cases, we sent letters to the parties transmitting a description of the FDIC Program and we asked them to tell us whether or not they would favor such a program for the grain warehousing industry and why. We also asked them to identify any concerns or potential problems that they believed the Committee should consider in deliberating the establishment of such a program. We made follow-up telephone calls to all groups not responding within a reasonable period. In all, we obtained the views of 84 respondents via either letter, personal interview, or telephone interview.

Appendix II details our methods for estimating the possible cost of a grain deposit insurance program. It also describes important assumptions we made that could affect the ultimate relevancy of the estimate.

We obtained information on state bonding requirements through telephone interviews with cognizant regulatory officials and review of materials which they provided. In all, we contacted 32 states that we considered likely to have bonding requirements. These states either (1) had bonding requirements as of our 1981 review of federal grain warehouse examination procedures,[1] (2) were members of the Association of American Warehouse Control Officials, and/or (3) were identified as having bonding requirements in information compiled by the Surety Association of America. As of January 1, 1984, the 29 states we found to actually require warehouse bonding (see app. III) accounted for about 80 percent of both off-farm grain storage facilities and capacity in the nation.

We obtained information on existing state and private indemnity/insurance programs through interviews (either personal or via telephone) with administering officials. We identified these state and private programs from testimony presented before the Ad Hoc Subcommittee on Grain Elevator Bankruptcy, prior GAO work, and our discussions with the Association of American Warehouse Control Officials and individual state and federal regulatory officials. The six states we found to have such programs (Illinois, Kentucky, New York, Ohio, Oklahoma, and South Carolina) accounted for about 18 percent of off-farm grain storage facilities and 21 percent of

[1]More Can Be Done to Protect Depositors at Federally Examined Grain Warehouses (CED-81-112, June 19, 1981).

off-farm grain storage capacity in the nation as of January 1, 1984. We had no practical means of estimating the proportion of the industry covered under the two existing private insurance programs that we found in existence.

We drew information on FDIC from prior GAO reports and FDIC publications. FDIC reviewed the description of its operation that we sent to interested parties when asking for their views and provided minor factual updates, which we incorporated in this report.

We performed our audit work between September 1983 and November 1984. We made our review in accordance with generally accepted government auditing standards.

APPENDIX VIII

United States Department of Agriculture
Agricultural Stabilization and Conservation Service
P.O. Box 2415
Washington, D.C. 20013

DEC 03 1984

Mr. J. Dexter Peach, Director
Resources, Community, and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We appreciate the opportunity you have provided us to review your draft report entitled Issues and Information Relevant to Establishing a Federal Deposit Insurance Program for Grain Warehouses. We offer the following comments:

1. Costs and Benefits — We recognize that the purpose of your study is to provide information about the principal issues and problems associated with establishing an insurance program for the grain warehouse industry, but not to make recommendations. However, in avoiding recommendations it seems to us you have also avoided carrying out the information you have presented to its logical conclusion. The Illinois study you cite indicates that there was a loss to grain account claimants of about $35 million during something over eight years. That amounts to over $4 million a year. At the same time your draft report indicates that the minimum cost of an insurance program is $41 million annually and might go as high as $72 million. Commercial storage stocks in the eight States covered by that study normally account for about half of the grain in the country. Therefore, if the losses annually were about twice what is reported in the Illinois study, even say $10 million, the cost of such a program would be at least four times the benefits. We think your report ought to make that clear.

2. Cost Effect on the Commodity Credit Corporation (CCC) — It is uncertain what the cost effect on CCC would be. (However, based on the analysis above, we suspect it would be detrimental.) At present, CCC is paying part of the costs associated with both Federal and State warehouse examinations. Presumably, with an insurance program that would no longer be necessary. However, if the costs of the insurance program were borne by warehousemen, the direct costs for examinations would be eliminated but probably more than offset by increased storage costs to CCC. Thus, it seems likely that such a program would cost CCC significantly more and the added cost would not be offset by additional benefits.

3. Unit Costs — We question whether or not program costs per bushel should be calculated on the basis of grain stored commercially. If the program is intended to cover all grain deposits by producers, we believe that the quantity for determining unit costs should be around 10 billion bushels. The annual production for grain is 14-15 billion bushels.

Subtracting four to five billion bushels both for use on the farm and for direct cash sales from the farm leaves about 10 billion bushels that enter the commercial marketing chain each year. Consequently, the basis for determining unit costs would appear to be more like 10 billion bushels rather than the 2.0 to 4.1 billion bushels used in your report.

4. Number of Federally Licensed and Contract Warehouses -- In appendix VI, p. 26, 3rd full paragraph has some inaccuracies in it. We would suggest the following paragraph in lieu of the one in the draft report:

> As of May 1984, there were about 1,700 federally licensed grain warehouses and 6,300 Uniform Grain Storage Agreement (UGSA) warehouses. (According to the Chief of USDA's Warehouse Development Branch, almost all of the federally licensed facilities also held UGSA's.) As of that time, only about 2,600 of the UGSA facilities were storing grain for CCC. However, all warehouses are examined at least once annually. In addition, there were about 700 warehouses approved as Payment-In-Kind (PIK) handlers which were dropped from the list of approved UGSA warehouses following the end of the PIK program.

Again, thank you for the opportunity to comment on your draft report. We hope these comments are useful to you.

Sincerely,

Everett Rank

Administrator

[GAO Note: Page reference has been changed to conform to the final version of the report.]

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